UNIVERSITY OF JOHANNESBURG

Department of Finance and Investment Management

Financial Operations

ADFM003

LAST ASSESSMENT OPPORTUNITY
June 2016

Time: 180 minutes **Marks: 100**

Assessors: Ms M McGill

Moderator: Ms B Xaluva

External Moderator: Mr W Smith

INSTRUCTIONS:

- This question paper consists of **14 pages**. Please ensure that you have all pages.
- You are allowed 180 minutes to answer this question paper.
- ALL answers must be written on the answer sheets provided. Answers or notes written on the question paper will **not** be submitted for marking.
- Silent, non-programmable calculators may be used, unless otherwise instructed.
- Where applicable, show all calculations clearly.
- Answers with Tippex or in pencil will **not** be marked.
- **Scratch out open spaces and empty pages. NO REMARK will be considered if there are any open spaces that have not been scratched out.**
- Number the pages of your answer sheets.
- Hand in ALL answer sheets.
- **NO CANDIDATE IS PERMITTED TO LEAVE THE EXAMINATION HALL IN THE LAST FIFTEEN MINUTES OF THE ASSESSMENT OPPORTUNITY PERIOD.**

Section	Marks	Time
A	25	45 minutes
B	25	45 minutes
C	50	90 minutes
	100	**180 minutes**

Taxation assumptions:

Unless otherwise specified, only the following rules for taxation of corporate profits will be relevant, other taxes can be ignored:

Accounting rules on recognition and measurement are followed for tax purposes.

- All expenses other than depreciation, amortisation, entertaining, taxes paid to other public bodies and donations to political parties are tax deductible.

Tax depreciation is deductible as follows:

- 50% of additions to Property, Plant and Equipment in the accounting period in which they are recorded;
- 25% per year of the written-down value (i.e. cost minus previous allowances) in subsequent accounting periods except that in which the asset is disposed of;
- No tax depreciation is allowed on land.

The corporate tax on profits is at a rate of 25%.

No indexation is allowable on the sale of land.

Tax losses can be carried forward to offset against future taxable profits from the same business.

Value Added Tax

Country X has a VAT system which allows entities to reclaim input tax paid. In country X the VAT rates are:

Zero rated	0%
Standard rated	15%
Exempt goods	0%

SECTION A [25 marks]

QUESTION 1 (25 marks)

REQUIRED:

Select the correct option by WRITING the corresponding letter of the answer on the paper provided.

Question 1.1

Which of the following is NOT a form of short-term investments?

A Treasury bills
B Factoring of trade receivables
C Local authority bonds
D Bank deposits. **(1)**

Question 1.2

An entity purchased new computer equipment for R36,000 during the year. The profit for the year (excluding depreciation) was R64 000.

The corporate income tax rate applicable to profits was 25%. The computer equipment qualified for first year tax writing down allowance of 50%.

Calculate the tax payable for the year. Give your answer to the nearest whole number. **(2)**

Question 1.3

An entity is preparing its cash forecast for the next three months.

Which of the following items should be excluded from the calculations?.

A Payment of last year's tax assessment
B Monthly payments due on the finance lease
C Receipt of a bank loan negotiated for the purchase of a new office building
D An expected gain on the disposal of an old factory site

(2)

Question 1.4

Which of the following would be classified as an associated entity of P according to IAS 28 Investment in Associates and Joint Ventures?

A P acquires 35% of Q's equity shares but cannot exert any influence on Q due to another entity controlling 60% of Q's equity
B P acquires 55% of the equity shares in S
C P acquires 80% of non-voting preferred shares in T
D P acquires 15% of the equity shares in R and can exert significant influence over the financial and operating policy decisions of R

(1)

Question 1.5

Which of the following is LEAST likely to be a reason for governments to set deadlines for filing returns and paying taxes?

A So that tax payers know when to pay their taxes.
B It enables the tax authority to forecast its cash flow more accurately
C It provides a reference point for penalties for late payment.
D To ensure tax is paid more quickly.

(1)

Question 1.6

According to IFRS 10 *Consolidated Financial Statements*, which TWO of the following are conditions that need to be satisfied if a parent entity is to be exempt from preparing consolidated financial statements?

i) The parent entity is itself a wholly owned subsidiary of another entity.
ii) The parent entity only has one subsidiary
iii) The parent entity's debt or equity instruments are not traded in a public market.
iv) The parent entity does not hold more than 60% of its subsidiary's equity shares.
v) The parent entity's control is obtained through an agreement with its subsidiary rather than an equity share holding

A i, v
B i, iii
C ii, iv
D iv, v

(2)

Question 1.7

An entity, ZZ is experiencing a long working capital cycle compared to its rivals and is examining ways to reduce the time taken to convert inventory in to cash.

You are advising ZZ on the methods that can be used to reduce the working capital cycle.

Which of the following would NOT help ZZ shorten its working capital cycle?

A Increase the length of credit given to trade receivables
B Reduce the value of raw material inventory held
C Reduce production volumes
D Delay payments to trade payables **(1)**

Question 1.8

The following Information relates to the year ended 31 December 2001.

	R
Total revenue for the year (80% 0n credit, 20% for cash)	7 812 500
Trade receivables at 1 January 2001	1 100 000
Trade receivables at 31 December 2001	1 400 000

Calculate the trade receivables days ratio based on average receivables (to the nearest day) **(2)**

Question 1.9

A parent entity acquired 75% of the equity shares in a subsidiary entity for R156 000. The remaining 25% of the equity shares were valued at R36 000.

The net assets of the subsidiary were R170 000 at acquisition

Assuming that the non-controlling interest is valued using the fair value method, which of the following is the correct value that should be included for goodwill in the consolidated statement of financial position?

A R28 500
B R22 000
C R64 500
D (R26 000) **(2)**

Question 1.10

An entity has been offering 60 day payment terms to its customers, but now wants to reduce its working capital cycle and improve its cash flow. The entity is proposing to offer 1.5% discount for payment within 28 days.

Assume an invoice of R1 000.

Calculate the effective annual compound interest rate that will be incurred if this proposal is adopted.

Give your answer to one decimal place **(1)**

Question 1.11

An entity, resident in Country X, had accumulated tax losses of R160,000 at 31 December 2002. The entity had a taxable profit of R240,000 for the year ended 31 December 2003.

Relevant Tax Rules
Corporate Profits

The following rules for taxation of corporate profits/losses are as follows:

- Accounting rules on recognition and measurement are followed for tax purposes.
- The corporate tax on profits is at a rate of 25%.

Tax losses can be carried forward to offset against future taxable profits from the same business.

For the year ended 31 December 2003 the entity will:

A pay no tax for the year and carry forward a loss of R100,000.
B pay R50,000 tax for the year and have no loss to carry forward
C pay R20,000 tax for the year and have no loss to carry forward.
D pay R80,000 tax for the year and have no loss to carry forward. **(1)**

Question 1.12

An entity purchased an asset for R90 000, exclusive of acquisition expenses of R3 000 on 1 January 20X5.

The asset was sold on 31 December 2008 for R125 500, net of disposal costs.
The asset qualified for indexation, the relevant index increased by 20% between 1 January 2005 and 31 December 2008.

Assume capital gains tax at 25%.

How much capital gains tax is payable on the disposal of the asset?

A R 3 475
B R 3 625
C R 5 275
D R 6 500 **(2)**

Question 1.13

Burden Ltd is the sole subsidiary of Beach Co. The cost of sales figure for 2004 for Beach Co and Burden Ltd are R28.8 million and R21.8 million respectively. During 2004 Beach Co sold goods which had cost R4.8million to Burden Ltd for R7.2 million. Burden Ltd has not yet sold any of these goods.

What is the consolidated cost of sales figure for 2004?.

A R 34.2 million
B R 45.6 million
C R 50.4 million
D R 52.8 million **(2)**

Question 1.14

What is the main objective of an external audit?

A To prevent and detect fraud and error
B To provide assistance to a client's management in preparing accounts
C To ensure that an adequate system of internal controls is maintained
D To provide a report on the truth and fairness of the view given by the accounts **(1)**

Question 2

List the four enhancing qualitative characteristics of financial statements identified in the Conceptual framework **(4)**

END OF SECTION A

SECTION B [25 marks]

QUESTION 3 (10 marks)

Smart Pass is a small local corporate entity that operates a transport business in Country X.

On 1 April 2013 Smart Pass acquires an additional vehicle that qualified for tax depreciation allowances. The vehicle cost R46 000 and has an expected useful life of 7 years with a residual value of R4 000.

The appropriate accounting entries for this vehicle have been included in the accounts.

Extract from Smart Pass's financial statements:

Smart Pass Statement of financial position as at 31 March 2013

Non-current liability	
Deferred tax provision	R155 000
Current liability	
Tax payable	R30 000

Smart Pass's Statement of profit or loss (extract) for the year ended 31 March 2014

Revenue	R260 000
Expenses	R175 000
Profit before tax	R85 000

Statement of cash flows for the year ended 31 March 2014

Tax paid	R33 000

Additional information:

1. Revenue includes a non-taxable government grant of R5 000.
2. Expenses include:
   a. Depreciation charges of R19 000 for Smart Pass's other non-current assets. These assets qualified for tax depreciation allowances of R22 000.
   b. Entertaining cost of R3 000.

REQUIRED

3.1 **Calculate** Smart Pass's corporate income tax due for the year ended 31 March 2014. **(10)**

QUESTION 4 (5 marks)

RD operates in Country A and has established the A$ as its functional currency.

RD acquired a piece of machinery from an overseas supplier at a cost of B$5 million on 20 November 2013. The invoice remained unpaid at the year ended 31 December 2013.

Relevant exchange rates (where A$/B$ 2.00 means A$1 = B$2.00) are:
20 November 2013 A$/B$2.00
31 December 2013 A$/B$2.15

REQUIRED:

In accordance with IAS 21 *The Effects of Changes in Foreign Exchange rates*:

4.1 **Explain** how RD would have established the A$ as its functional currency; and **(2)**

4.2 **Calculate** the amounts to be included in the financial statements of RD for the year to 31 December 2013 in respect of the above transaction. **(2)**

QUESTION 5 (10 marks)

Netley Ltd is considering a change of credit policy which will result in a slowing down in the average collection period from one to two months. The relaxation in credit standards is expected to produce an increase in sales in each year amounting to 25% of the current sales volume.

Sales price per unit	R10
Profit per unit (before interest)	R1.50
Current sales revenue per annum	R2.4 million

The required rate of return on investment is 20%.

Assume that the 25% increase in sales would result in additional inventories of R100 000 and additional payables of R20 000.

REQUIRED

5.1 **Advise** the company on whether or not it should extend the credit period offered to customers if all customers take the longer credit of two months. **(10)**

SECTION C [50 marks]

QUESTION 6 (25 marks)

Part A (15 marks)

On 1 April 2013 Bombai acquired 100% of Kings 500 000 R1 equity shares.

	Kings R'000
Cost of acquisition	975
Retained earnings at 1 April 2013	170
Retained earnings at 31 March 2014	230

The fair value of net assets of Kings on 1 April 2013 was R140 000 more than it's carrying value.

On 31 March 2014 goodwill arising on Bombai's investment in Kings had been impaired by 20%.

REQUIRED

6.1 **Calculate** the goodwill that will be included in Bombai's statement of financial position at 31 March 2014. **(5)**

6.2 **Explain,** with supporting calculations, how Bombai's consolidated interest in King would affect its consolidated statement of financial position at 31 March 2014. **(10)**

Part B **(10 marks)**

Black acquired 100% of White's ordinary shares on 1 January 2011 for R 1 136 000 when White's retained earnings were R260 000. At 1 January 2011 the fair value of the net assets of White exceeded their carrying value by R110 000. The remaining useful life of these assets was 11 years from acquisition.

White has not issued any new shares since acquisition by Black. White is Black's only subsidiary.

Black calculated goodwill in its subsidiary was impaired by 20% at 31 December 2013.

The equity of White as at 31 December 2013:

	R'000
Ordinary share capital	430
Share premium	86
Retained earnings	324
	840

The retained earnings of Black were R2 100 000 at 31 December 2013.

REQUIRED

6.3 **Calculate** the amount that Black should include in its consolidated statement of financial position as at 31 December 2013 for retained earnings. **(5)**

6.4 **Calculate** the amount that Black should include in its consolidated statement of financial position as at 31 December 2013 for goodwill. **(5)**

QUESTION 7 **(25 marks)**

EBS Financial Statements for 30 June 2014 include the following:

EBS Statement of profit or loss and other comprehensive income for the year ended 30 June 2014:

	Notes	**R'000**
Revenue		2 610
Cost of Sales	6,8	(890)
Gross Profit		**1 720**
Administrative expenses		(180)
Distribution costs		(125)
Profit from operations		**1 415**
Finance cost		(57)
Profit before tax		**1 358**
Income tax expense		(160)
Profit for the period		**1 198**
Other comprehensive income		
Revaluation gain on properties	2	345

EBS Statement of financial position at 30 June

	Notes	**2014**		**2013**	
Non-current assets					
Property, plant and equipment	1,2,3	5200		4890	
Deferred development expenditure	6	184		76	
Brand name	6	45	5 429	60	5026
Current assets					
Inventories		130		105	
Trade receivables		273		189	
Cash and cash equivalents		169	572	210	504
			6 001		**5 530**
Equity					
Equity shares		2 200		1 800	
Share premium		580		400	
Revaluation reserve		345		0	
Retained earnings		2 006		1 420	
Total equity			**5 131**		**3 620**
Non-current liabilities					
Long term loans		0		1 435	
Deferred tax		196		110	
Preferred shares		300	496	0	1 545
Current liabilities			**374**		**365**
			6 001		**5 530**

Additional information:

1. Non-current assets – property, plant and equipment, balances at 30 June were:

	2014	**2013**
Cost or valuation	R'000	R'000
Property	3 825	3 900
Plant	3 000	2 850
Equipment	1 235	1 120
	8 060	**7 870**
Depreciation:		
Property	45	420
Plant	2 000	1 700
Equipment	815	860
	2 860	**2 980**
Net book value	**5 200**	**4 890**

2. On 1 July 2013 property was revalued to R3 825 000. At that time the average remaining life of property was 85 years. Property is depreciated on a straight line basis.
3. Equipment with a carrying value of R60000 (original cost R210 000) was sold during the year for R25 000. Any gain/loss on disposal of property, plant and equipment is included in profit or loss.
4. Current liabilities

	2014	**2013**
	R'000	**R'000**
Trade payables	218	230
Loan interest payables	4	15
Tax payable	90	120
Other provisions (see note 3)	62	0
	374	**365**

5. EBS paid a dividend on its equity and preferred shares during the year ended 30 June 2014.
6. Cost of sales includes R27 000 for development expenditure amortised during the year and R15 000 for impairment of the purchased brand name.
7. On 1 November 2013, EBS issued R1 equity shares at a premium. On 1 July 2013 EBS issued 6% cumulative redeemable preferred shares at par. No other finance was raised during the year
8. Other provisions relate to legal claims made against EBS during the year ended 30
9. June 2014. The amount provided is included in cost of sales

REQUIRED

7.1 **Prepare** EBS's Statement of Cash flow, using the indirect method, for the year ended 30 June 2014 in accordance with IAS7 *Statement of Cash Flows*.

Notes to the financial statements are not required, but all workings must be clearly shown **(25)**